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WORLD INVESTMENT REPORT

Global outflows of foreign direct investment soared in 2000 to a record $1.3 trillion, but are expected to decline this year, according to the recently released World Investment Report 2001, published by UNCTAD, the United Nations Conference on Trade and Development. In this edition of **World Chronicle,** Karl Sauvant, Director of UNCTAD's Division on Investment, Technology and Enterprise Development, talks about the consequences of the decrease in foreign direct investment for the global economy.

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ANNOUNCER: From United Nations Headquarters in New York, this is **World Chronicle**, an unedited interview programme about major global issues.

Here now to introduce our guest is the host of today's **World Chronicle**.

LITTLEJOHNS: I'm Michael Littlejohns, and this is **World Chronicle.**

According to the World Investment Report 2001, published by the United Nations Conference on Trade and Development, UNCTAD, foreign direct investment is reaching many more countries now than in the past. The number of countries receiving an annual average of more than $1 billion rose from 17 in the mid-1980's to 51 at the end of the 1990's. But, there are also signs that the world economy is shrinking. Last year, for the first time in almost 20 years, the total amount of foreign direct investment entering Latin America fell, by over 20 percent. Is this just a blip or the first sign of a new downward trend?

Our guest today is Karl Sauvant, Director of the UNCTAD Division of Investment, Technology and Enterprise Development. Joining me to talk to Mr. Sauvant are Ian Williams of *The Nation* and Tuyet Nguyen of the *German Press Agency/DPA.*

Mr. Sauvant, welcome to **World Chronicle.**

LITTLEJOHNS: The world investment report of 2000 was released on September the 18th , which was a week after the tragic events of the World Trade Center and the Pentagon, which surely have had a profound effect on the global economy including foreign direct investment. Have your people yet been able to come up with a meaningful analysis of the effect?

SAUVANT: Well, Michael, this is of course a very important question. Actually, before the release of the World Investment report, and in finalizing the 2001 world investment report, we had already made an estimate as to investment flows in 2001. And we had arrived at the conclusion that in all likelihood, foreign direct investment flows, which were 1.3 trillion in the 2001, would decline by about 40% worldwide in the year 2001. That has to do primarily with the slow down of economic activity in general, and it has in particular to do with the decline in cross border mergers and acquisitions, which were particularly important in the last two years in terms of fueling the investment boom. The slow down of cross board mergers and acquisition of course is also related to economic and uncertainties. So even before the tragic event on 11th September, we expected a slow down in terms of foreign direct investment flows. Now the 11th September events in our analysis are likely to accentuate this slow-down in investment flows.

LITTLEJOHNS: By how much would you think?

SAUVANT: We have not the slightest clue. It is still very much up in the air, and it depends very much on the key factors driving foreign direct investment, which is economic growth, which is cross border mergers and acquisitions, which could indeed, if indeed there is a further slow down in economic growth, could actually accentuate the slow down in foreign direct investment.

LITTLEJOHNS: Are transnational corporations, would you say, becoming a little more nervous about investing in enterprises, in developing countries, or anywhere overseas?

SAUVANT: That is difficult to say because the underlying factors, that have been driving foreign direct investment, really haven't change that much. The underlying factors are technology, which allows you to run a worldwide network of affiliates, liberalization of investment regimes, which allow you to actually invest abroad. In fact, it may well be that in response to the decline of foreign direct investment, competition for foreign direct investment will become more intense, and as part of that it's quite possible that some countries will actually liberalize further, perhaps open some sectors further, and then, in turn, could increase foreign direct investment flows. So these two factors, technology and liberalization haven't changed. And all of that, of course means that competition, international competition for firms, to be competitive internationally means, more than in the past even, that firms are present in the main markets, including for foreign direct investments, that firms establish themselves in the main markets in order to utilize the resources, not only the natural resources, but also the skills and technology of these markets. And therefore, foreign direct investment, we would expect, will continue to grow in the future again. So these underlying factors, I think, are key to the further expansion of foreign direct investment flows.

WLLIAMS: One of the outstanding things, I was looking at the figures from the US Department of Trade, a few days ago for another story, is the huge amount of money, European and Japanese money that's been flowing in to America consistently over the last few years. America, the United States has effectively become a creditor nation. It's financing its balance of payments. Are there any signs that this sort of flood of capital will suddenly go gurgling out again as people worry about the U.S. and terrorist attacks?

SAUVANT: Well, let me respond to that part of the question that deals with direct investment -- not on the broader monetary and other implications of, you know,

the terrorist attacks and the slow down of the world economy. And as far as the investment side of the picture is concerned, the key factor remains that the United States is the single biggest market, national market in the world with an endowment, in terms of skills and technology, which makes it almost imperative for companies to be established in this market. This is not going to change. So on the foreign direct investment side, the foreign direct investment side, I would not expect that you would have significant withdraws of investments, direct investments made in the U.S. market.

WILLIAMS: This 40%, has this been across the border, or have the developing countries suffered more than the developed countries and the U.S.?

SAUVANT: A very good question. As it happens, as I mentioned before, a good part of foreign direct investment flows, in the last two or three years, were actually fueled by cross border mergers and acquisitions. And most of these take place among developed countries. So the decline is reflected, is affected by that. We expect that we will see a decline of almost 50% of foreign direct investment flows between developed countries. While decline of foreign direct investment flows in developing countries may be in the neighborhood of six or seven per cent or considerably less. And the reason there is that most of foreign direct investment flows in developing are indeed in the form of green field investment, new investment, so they are not affected by the merger and acquisition boom and bust if you want. And of course you have, we shouldn't forget, that you have a number of markets in the developing world, China is perhaps the prime example, that continue to boom and will attract foreign direct investment. We expect China, which had approximately 40 billion dollars in foreign direct investment in the year 2000, might well have over 50 billion this year. So that of course, you know, is a positive factor for overall flows to developing countries.

NGUYEN: How did you see the role of China, once it has been fully admitted to the World Trade Organization? Will the trade continue to grow in terms of investment? And whether Taiwan, which is scheduled to join WTO right after China, will be affected as a whole? China and Taiwan. What will be there role then?

SAUVANT: Our expectation is, and we have specially analyzed this question, that the admission of China to the WTO will actually contribute to increase investment flows for a number of reasons, one of the reasons being that it becomes a more stable

and predictable frame work, another being that perhaps some of the requirements that China had imposed on foreign investors may be phased out, and making it easier to invest in China, so I think these will all weigh positively on investment inflows to China. There is another development, which appears to be taking shape, and that is apparently that there are considerations of whether cross border mergers and acquisitions into China should be facilitated if not encouraged, and of course if that takes place, it might contribute to a substantial increase in foreign direct investment. Now what that means to other countries or economies in the Asian area is difficult to say at this point. It is clear that the overall share of for instance, the Asian, the other Asian economies in the total inflows into Asia has declined because China has attracted a lot of FDI. But the absolute amounts have not necessarily declined. But what is clear, is that the competition for foreign direct investment in that region will increase.

NGUYEN: I want to ask you also, you know, because of the situation in the U.S. military campaign against terrorist organization. And because of that the U.S economy is said to move toward a war economy. I don't know if it is true. If it does take place and if the military campaign continues for longer years, what influence will it have on investment worldwide?

SAUVANT: I am really in no position to speculate on that because there are so many unclear factors that it is simply not possible, at least for me, and at least at this point to speculate what that might mean.

LITTLEJOHNS: Mr. Sauvant, tell us a bit about foreign direct investment, FDI, in continents like Africa, Latin America, and the Eastern part of Europe. What can you tell us about that situation?

SAUVANT: Well, I mentioned before that foreign direct investment had actually reached record levels in the year 2000: 1.3 trillion. As in the past, most of this investment was actually among developed countries - practically one trillion dollars. Developing countries received about 240 billion dollars, which is the highest figure ever, as far as...

LITTLEJOHNS: Is Eastern Europe considered developing...?

SAUVANT: No. Developing countries, in Asia, Africa, and Latin America. Two hundred and forty billion dollars in 2000 compares to forty billion dollars of

worldwide investment flows at the beginning of the '80's. So it is a considerable amount of money and far more important for instance than official development assistance that developing countries receive. Now Central and Eastern Europe have been pretty study at a between 20 and 25 billion dollars, and can be expected this year, in the year 2001, to be as stable as before. Now within the developing countries, you have already referred to Latin America as experiencing a drop. We should however be careful about this drop because it is a drop between the year 99 and 2000 – that is correct. But '99, it is not a drop compare to '98. The reason is partly that last year, as in the year 2000, a number of major cross border mergers and acquisitions took place in Latin America, as a result of which investment flows to Latin America were particularly high. So it is a bit of an adjustment. Africa remains pretty much between 8 and 10 billion dollars, which...

LITTLEJOHNS: It is not very much, is it?

SAUVANT: It is not very much. It is not very much in absolute terns, but it is a lot if you put it in relationship to gross domestic capital information, in other word total investment...

WILLIAMS: And most of that is in South Africa, isn't it? It's various local markets, I thought.

SAUVANT: No, no, no no. It is actually much more. South Africa doesn't get that much for direct investment. It is much more in some of the natural resource attracting countries, including Angola, but also Morocco, Egypt and a number of other countries. Uganda is doing quite well, for instance.

LITTLEJOHNS: This is **World Chronicle.** Our guest is Karl Sauvant, Director of the UNCTAD Division on Investment, Technology and Enterprise Development.

WILLIAMS: I believe, the last time we spoke about this wasn't long after the South East Asian currency crisis, or it was around that period. And of course, that, for some countries, put the whole question of FDI into sort of relief when all of the funds that had flooded in and flooded out with the big gurgle and left them high and dry. And of course there have been several responses since then, and the one that was derived at the time that I think has since actually been praised by others was Malaysia, where they sort of put a freeze

and sort of exchanged controls to stop the money flooding out as quickly. Have they paid a price for that, or has it been vindicated, as far as investors are concerned?

SAUVANT: Well, we have to distinguish in looking at this question. We have to distinguish basically between portfolio investment and commercial bank lending on the one hand, and direct investment on the other hand. Portfolio investment by definition is short-term investment, which can come in and out as investors see fit in response to whatever the economic developments are. Foreign direct investment typically is long term. So what you actually saw during the financial crisis in Asia is that portfolio investments went into negative, while direct investment remained at the same level. In other words, companies actually expanded because the value of the currency went down, actually expanded in these countries, international companies, and international companies not only from developed countries, but also from Singapore, and from other developing countries expanded in these countries, precisely, precisely because they are taking a longer term view in terms of what their own competitive positions are in the world economy in terms of having access to key markets. And I think this is a very important distinction to keep in mind – that portfolio investment and foreign direct investment, and of course there are overlaps, some portfolio investments stay longer, some foreign direct investments can be fast. But foreign direct investment is really an investment into the economy, a long-term commitment to the economy of a country, and therefore much more stable, in most economic situations.

WILLIAMS: Where would you put?... because most of the tendencies in some of these developing world, although Taiwan isn't quite it, but I think for example of the Taiwan semi-conductor plant or emphasis in India, which are listed in European and American stock exchanges. Is that foreign direct investment? If I buy it, if I buy stock in Taiwan semi conductor on the New York Stock Exchange, is this foreign investment, or is it internal flows? How is this accounted?

SAUVANT: Well, the definition of foreign direct investment is, if you should acquire 10% of a particular company or more, and with a view to exercise management control and basically running the company if possible, then you will become a foreign direct investor. But if it is stock, then it is simply portfolio investment. So the key variables is control, that you want to exercise control over. And that there is the time dimension; in fact, it should be at least a year, in terms of investment. Now in reality, this may be sometimes

difficult to distinguish in some transactions. But most foreign affiliates, and we estimate that there are over nine hundred thousand, probably many more, most foreign affiliates are actually majority, if not wholly owned by the parent company. So they are clearly part of an international production network, that are increasingly being established by firms, precisely to be present in all markets, and to have an international, intra-firm division of labour within which firms can produce as competitively as possible.

NGUYEN: The merger and acquisition train was held by all these linkages between suppliers and the transnational corporations. But you said the economy is declining. What would be the merger and you know the trend, merger and acquisition trend would be in the future?

SAUVANT: Well, we have looked into this matter, and we feel that although you might have waves of cross-border mergers and acquisitions, these are not waves on an axis like this, but rather on an axis like that, meaning that you will have a secular trend, so to speak, of an increased number and value of cross-border mergers and acquisitions with the driving forces precisely going back to the question of liberalization, you know, technology and increased competition. But you mention also one aspect, which is of key importance, and which is actually a key issue addressed in the World Investment Report of 2001, and that is linkages between foreign affiliates and domestic firms. And I think this is an issue that will require increasing attention, especially by host countries wanting to benefit as much as possible from foreign direct investment, because it is precisely through these linkages, between foreign affiliates and domestic enterprises that technology can be transferred, that, you know, skills can be upgraded, that access can gained to international market, and therefore that a more valuable and domestic enterprise sector, after all the bedrock o economic development, can be developed. So we are looking into this particular question in this report, in order to identify a number of best practices for companies as well as for countries to promote linkages between foreign affiliates and domestic firms.

WILLIAMS: You mentioned... I am sorry.

NGUYEN: You know India in South Asia, is the only country that has been receiving foreign direct investment, two billion dollars, I think, last year. Will it be affected with the war in Afghanistan, and the conflict, possible conflict with Pakistan, in the future?

SAUVANT: India has received, not much foreign direct investment. I think it is more of five to six billion dollars. But nevertheless, it is very little. India has embarked on a course in which it is trying to seek to attract more foreign direct investment, in particular in priority sectors, including infrastructure, which are central to its own development and considering that India is attracting very little investment, especially if you compare, let's say, with a country like Singapore. Singapore attracts as much investment as India does. Or China; China attracts some 40 billion dollars. I think there is a great potential for more foreign direct investment in India, and it will very much depend on actually the decision makers in India, whether they would like to attract more investment, and if so, in what sectors.

WILLIAMS: You mentioned about the linkages. I am interested because, in the past, when I have looked at this foreign affiliates, are the first to pull out of an area during a depression, you know there are regions in Britain and others where these people don't cry on your shoulder when you sack them. So it is much easier to sack somebody 3000 miles away than it is at home. So, I am interested in what you are doing about the linkages. I can see the advantage for the local economy of building, of using the foreign affiliates as engines for economic growth and domestic enterprise development. But what an advantage is there for the incoming company to be tied in in this way?

SAUVANT: Well, the linkages are only built if there is a mutual interest between the foreign affiliate and domestic enterprise. And I think the interest of the foreign affiliate is to reduce costs, primarily to reduce costs. As you know, there is a trend toward outsourcing, and manufacturing -- for instance, over half of the inputs are actually outsourced, are being obtained from enterprises outside the company. So a foreign affiliate has very, every interest to obtain its inputs from local sources if these are up to standards, in terms of quality, and can be delivered on time, and, of course, are cheaper. They tend to be cheaper because they are local as opposed to international if only because of transportation costs. Foreign affiliates actually, and we have documented in the report a number of cases, have made even their own programmes in order to develop local linkages. I mean in some industries, like the food industry, that's absolutely necessary because you cannot transport milk or whatever over 5,000 miles or so. So I think there is a mutual interest and the issue is

now for policy, for policy makers, to see that these mutual interests are actually stimulated, and when necessary perhaps encouraged through government incentive or other matters.

LITTLEJOHNS: Mr. Sauvant, if there were a very steep decline in FDI, much steeper than your report mentions, what might the social impact be in developing countries? Is that a worrisome thing?

SAUVANT: Well, I think the worrisome thing is not so much for foreign direct investment per say, a declined foreign investment per say, but rather a decline of economic growth, of which then a decline of foreign investment would be a reflection. Don't forget foreign direct investment, while it is an important complement and catalyst, nevertheless is a complement and a catalyst, meaning that domestic investment in most countries is of key importance. And if you have an economic down turn, you would have not only a down turn in terms of foreign direct investment, but also domestic investment with all what that implies for unemployment and incomes of countries. So in that sense a decline in foreign direct investment would accentuate what is or what may be already happening as a result of the economic slow down. And therefore, conversely, it is important to instill confidence and to see that economic growth is being accelerated again in order precisely to avoid possible consequences that you mentioned, and increase the possibility for growth and development.

WILLIAMS: Are there any worries about on underbidding, that sort of Dutch auction, by offering economic incentives for investors to come in? I mean even here in the United States, you see New Jersey bidding for factories from New York, offering cheap land, cheap transport, free infrastructure, free tax holidays, the usual. This can't be good for the economy really because people who come in on the basis of incentives like that, tend to leave as soon as the incentive finish before they sort of pay back. Is this a growing trend of countries underbidding each other to attract FDI?

SAUVANT: Yeah. It is certainly a phenomenon, which we have observed over the past 10 years or so. As I mentioned, the World Investment Market is a highly competitive market and the incentives, fiscal incentive, financial incentive, regulatory incentives are part of the armory, so to speak, of each country, or increasingly as you already indicated, sub-national units be they, for instance, states or even cities in order to attract foreign direct investment. And it is certainly a trend, which in many instances may not be to the advantage of the country involved, although it is very difficult to say, because it is not that

if a country attracts – let's say a factory - that once the incentive is gone, the company will leave because the company invests really and makes its analysis in most cases on the basis of the long-term prospects of a location. And in that sense incentives may be sometime icing on the cake: you take it if you get it, you know. But the long-term investment has to be profitable otherwise companies would not engage into such investments, as a whole at least.

LITTLEJOHNS: Mr. Sauvant, that's all the time we have. You have covered a lot of ground in a short time. Thank you for being with us on this edition of **World Chronicle.**

Our guest has been Karl Sauvant, Director of the UNCTAD Division on Investment, Technology and Enterprise Development. He was interviewed by Ian Williams of *The Nation* and Tuyet Nguyen of the *German Press Agency/DPA*.

I'm Michael Littlejohns. Thank you for joining us. We invite you to be with us for the next edition of **World Chronicle.**

ANNOUNCER: Transcripts of the programme may be obtained free of charge by sending a stamped, self-addressed envelope to **World Chronicle**, United Nations, Room S-827L, New York, N.Y., 10017.

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